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# Monthly Letter on

# Economic Conditions Government Finance

New York, February, 1953

## General Business Conditions

THE current business reports show that the economy is still operating at peak levels, and that business men generally are putting their faith in a continuance of active demand in the months ahead. Final returns, when they are in, probably will show that January has set another peacetime record in aggregate industrial production, continuing the uptrend that has run since the steel strike. Little further gain in employment and industrial output is possible, for many of the key industries are at capacity. However, the view that business can go along on this plateau for some time is increasingly accepted. Unemployment is abnormally low. Latest figures show weekly hours of work and hourly wage rates rising. Personal incomes therefore are still edging upward, though at a moderate rate, and providing the means for sustained consumer purchases.

The automobile industry is conspicuous among those which expect to sell all they can produce in the spring and summer. Last autumn the tendency in Detroit was to set probable passenger car sales for 1953 at 5 million units.

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Recent figures have gone beyond this. Mr. Curtice, who will succeed Defense Secretary Wilson as president of General Motors, has raised his sights to 5,500,000. Press reports say production schedules for the first half year total 3,100,000, to be reached if materials are available. With the machinery, equipment and defense industries as busy as they are, such a schedule virtually underwrites general industrial activity during that period.

Manufacturers of other consumers' durable goods, including television and most household equipment items, are similarly optimistic. They see high demand ahead and hope for relaxation of controls and more plentiful supplies of steel and other scarce materials. The construction industry is another which looks for a busy year. Opinions as to the probable number of housing starts center around a million, which is only a little below the 1,131,000 of 1952. Factory building also may be a little lower, but an increase in commercial, school, hospital, and other types of building needed to care for a growing and shifting population, and in highway construction, is counted on by almost all the prophets to hold aggregate construction at approximately the 1952 level. Restrictions on building have been coming off by stages since the removal of Regulation X last year.

### *Unfilled Orders High*

With expectations of this kind it is not surprising that unfilled orders remain high enough to assure sustained operations and that many industries continue under pressure. The chairman of the U.S. Steel Corporation, Mr. Fairless, reports that January orders for steel were ahead of a year ago and that the current backlog, representing nineteen weeks of capacity operations, is about unchanged from the September 1952 figure.

The merchandise industries have had the benefit of the excellent Christmas trade. Aggregate retail sales in December, including food and automobiles along with general merchandise,

were 10 per cent ahead of the same month a year earlier. This is an exceptional gain, which no one expects to be maintained. But inventories were cleared. Moreover, retail business has continued good in January. Buyers have come back into the wholesale markets, and the response to the seasonal openings has been satisfactory. By all signs the soft goods industries can market a greater production than they could last year, when distributors were working off stocks.

Business is good precisely because the industries and trades are supporting each other. The main difference between present conditions and those of a year ago is that the situation is better in lines which were then depressed, and activity is diffused more widely. The operations of each industry supply purchasing power for the products of the others. Sustained activity in the heavy industries, defense plants and construction supported the economy while inventories were pared down in consumers' goods, and now all are working together.

### *The Drop in Farm Prices*

The most discordant note in the good business news is the easiness in prices of basic commodities and particularly of farm products. Reports from the farm states – and from Congress also – indicate a growing concern as to farm purchasing power. Several farm spokesmen in Congress have already introduced bills to supplement and extend the present price support program. The fact that the drop has occurred in spite of a high level of industrial activity adds to the concern. Surpluses of farm products are accumulating, largely in stocks owned or financed by the Government, and exports face an uneasy future.

Continuing the steady decline which started late last summer, prices received by farmers in mid-January were 11 per cent below a year earlier. Two thirds of the 27 per cent rise in farm prices from pre-Korea to the February 1951 peak has been lost. At the same time, prices paid by farmers are higher than in February 1951, and only a little below a year ago. As a result the ratio of prices received to prices paid in January slipped to 95 per cent, lowest since March 1950. At the post-Korean peak in February 1951 it was 113.

It is natural that sentiment should be disturbed by changes of this extent, both in actual prices and in price relationships. Nevertheless, a "parity ratio" of 95 is a long way from indicating a serious agricultural recession. Prices of some products, cotton and wheat for example, may be close to bottom, since free supplies have been tightened by increased entries into the government loan stocks. Assuming moderately lower farm prices, but reasonably good crops, farmers' cash receipts from marketings this year should be fairly close to the record level of $33.5 billion estimated for 1952. With higher costs, farmers' net income likely will be somewhat below last year's estimated $14.2 billion. In real terms, the U.S. Department of Agriculture forecasts that the purchasing power of net farm income this year may be close to the postwar low of 1950. But this is not a discouraging comparison. Judged by prewar standards, 1953 evidently will be another good year. The financial position of farmers is excellent.

The drop in prices, however, has a significance which should not be lost to industry. The essential condition of prosperous trade is that prices and incomes shall be in balance; in other words, that sellers offer their goods in the markets at prices which people can pay. The farm market is one of the major segments of the economy. A decline in farm prices, relative to prices of what farmers buy, reduces farmers' real purchasing power.

Consumers, of course, may feel differently about the change than farmers do. After a decade of high food costs and frequent shortages, they welcome larger supplies and a chance to reduce expenditures for the food item in family budgets. They will have more money for other things. It is possible to argue that since Korea the farmer has had a position of advantage over the consumer, and that the decline, in fact, is bringing price relations into better balance. But this argument should not be pushed too far. Although the "parity ratio" is only a crude measure of the balance between farm and non-farm prices, with deficiencies which have often been discussed in these Letters, the decline nevertheless sounds a note of caution for manufacturers who sell to farmers. Labor union leaders also should heed the warning. It emphasizes the need for efficient management, individual effort, and restraint in labor demands, in order to keep down costs and prices of manufactured goods and keep trade moving.

## Discount Rate Increase

Announcement was made after the close of business January 15 that discount rates were being advanced from 1¾ per cent to 2 per cent, effective January 16, for the Federal Reserve Banks of New York, Philadelphia, Cleveland, Atlanta, Chicago, St. Louis, Minneapolis, and Kansas City. Similar advances for the Boston, Richmond, Dallas, and San Francisco Reserve

Banks were made the following week, creating a uniform rate of 2 per cent for all twelve Reserve Banks. The previous rate of 1¾ per cent had been held fast since August, 1950, shortly after the outbreak of the war in Korea. The indicated purpose of the new move was to bring the rate into better line with open market money rates and to keep a check-rein on credit expansion. At the seasonal peak of pressure on the money market in December bank borrowings from the Federal Reserve, at the former rate of 1¾ per cent, ran up as high as $2 billion.

In the longer perspective, the 2 per cent rate represents a further step in unwinding the extreme easy money policy adopted in the depression and war years. Previous to 1930, Federal Reserve discount rates never had been below 3 per cent and, on rare occasions, had gone as high as 6 and 7 per cent. During the years of currency inflation, 1933-45, the discount rates were moved down to 1½, 1 and ½ per cent, the last-mentioned being a preferential rate applied during the war to borrowings secured by short-term government securities. The preferential ½ per cent rate was discarded eight months after the close of the war. The standard 1 per cent rate, originally installed in 1937, was successively lifted to 1¼ and 1½ per cent during 1948 as a check on credit expansion. The 1¾ per cent rate adopted in August, 1950 was intended to counter the inflationary surge that followed the outbreak of the war in Korea. It was not fully effective until after the government securities market was unpegged under the Treasury-Federal Reserve Accord of March 3, 1951. As long as the authorities supported government security prices at fixed points, there was little need for banks to use the discount window.

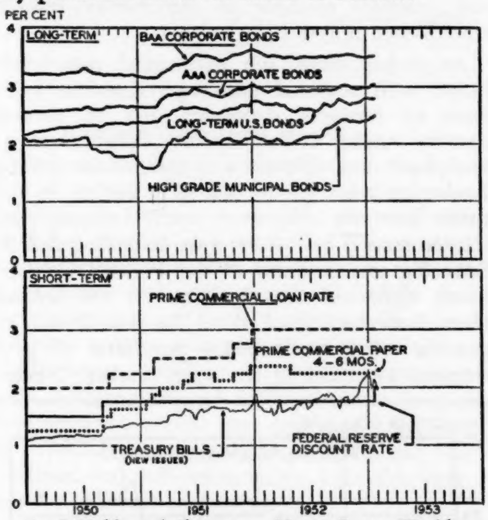
### *Offset to Seasonal Influences*

The new discount rate change clearly was not intended to have a jolting effect on credit supply, but rather to reinforce the caution of lenders at a time of the year when seasonal forces bring loan funds into surplus supply. The rate action tended to neutralize these easing influences and to fit into a money rate structure that had developed under the force of credit demands. In the circumstances, the change had little effect on the general structure of money rates. Indeed, the move was so logical, and the markets so well adjusted to it, that failure to act would have left the financial community divided between those apprehensive of a larger change and those inclined to foresee no change at all and a resurgence of easy money.

The following chart brings out the broad movements in money rates and bond yields since 1950. Aside from the broad growth in credit demands over the entire period, three major policy steps affected the pattern:

(1) the August, 1950 discount rate advance;
(2) the unpegging of the government bond market;
(3) the effective revival of the discount mechanism.

The August, 1950 advance in discount rate was followed by moderate advances in loan rates and short-term money rates although an essential factor in these changes was the strength of credit demands. Long-term bond yields were not particularly affected since the Federal Reserve Banks came to the support of the government bond market. The pegging operations, adding to bank cash reserves, also forestalled any particular need for banks to borrow.



**Bond Yields and Short-term Money Rates, Weekly**

The second major policy action was of greater import, the unpegging of the government bond market under the Treasury-Federal Reserve Accord of March 3, 1951. This action reacted particularly on the cost and availability of long-term money.

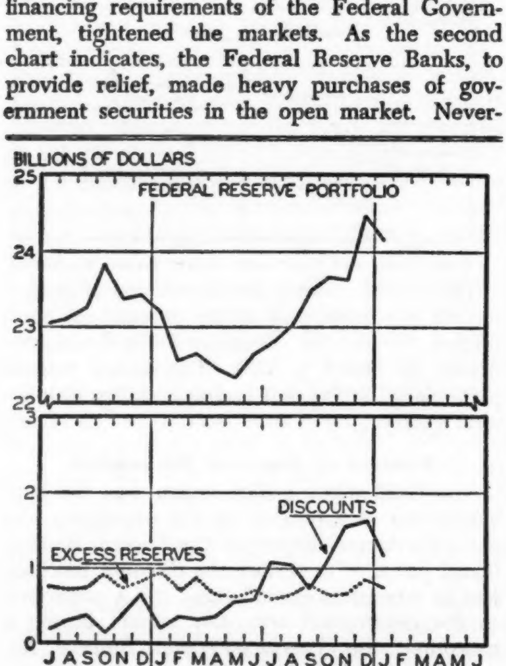
### *Revival of Discount Mechanism*

The third major policy action was the consummation of a purpose of the unpegging – as the 1951 Annual Report of the Federal Reserve Board put it – "to restore the discount mechanism as a restraint on inflation". As a protection to the government securities market during a transition, the Treasury-Federal Reserve Accord stipulated that the 1¾ per cent discount rate, "in the absence of compelling circumstances not then foreseen", would remain at 1¾ per cent during the remainder of 1951.

As the Federal Reserve drew back in its support of government security prices, pressure for funds forced banks to take resort to the discount window. Their reluctance to borrow acted as a curb on the supply of credit and resulted in money rate advances. In December, 1951, when the prime commercial loan rate was put up to 3 per cent – its present level – member bank borrowings made the highest daily average in eighteen years, $657 million.

At that time rumors were rife that the discount rate would be moved to 2 per cent. It is unfortunate in retrospect that the rate advance was not invoked in January, 1952, rather than a year later. Possibly the cost of living index could have been prevented from edging into new high ground during 1952. The market was adjusted to the prospect of a ¼ per cent change, and seasonal easiness in the money market would have relieved the impact.

As it happened, the unchanged rate, combined with seasonal ease and mistaken forecasts of business downturn, led to several months' run-up in bond prices. Prime commercial paper rates softened and competition among banks for loans led to talk of a decline in the prime loan rate. However, credit demands during the second half of the year, including deficit-financing requirements of the Federal Government, tightened the markets. As the second chart indicates, the Federal Reserve Banks, to provide relief, made heavy purchases of government securities in the open market. Nevertheless, record demands for currency and credit pushed member bank borrowings up to new peaks since 1921, beyond $1½ billion, and brought renewed upward pressure on money rates. While corporate bond yields held fairly steady, yields on U. S., State and municipal bonds worked higher, more particularly the latter in response to the record volume of new flotations. The Treasury shifted from 1⅞ per cent to 2 and 2⅛ per cent rates in rolling over maturing certificates of indebtedness. Yields on ninety-one day Treasury bills at the December peak reached 2¼ per cent, a full half per cent above the 1¾ per cent discount rate then prevailing.




**Federal Reserve Holdings of Government Securities and Member Bank Excess Reserves and Discounts**
**(Monthly averages of daily figures)**

As the first chart indicates, Treasury bill yields moved off from 2¼ to 2 per cent with the passing of year-end pressures, rose to 2⅛ per cent as expectations of discount rate action spread, and dropped a little below 2 per cent on the issue of January 29. Normally Treasury bill yields fluctuate around the discount rate, rising above when the money market is under pressure, and dropping below when the pressure is off. Rates on prime bankers' acceptances (not shown on the chart) moved up ⅛ per cent, to a minimum of 1⅞ per cent, following the discount rate change. Yields on corporate and municipal bonds stiffened slightly. U. S. bonds were steady.

The drop in Treasury bill yields, and the broad stability of other rates, in the face of the discount rate advance, were attributable to the passing of year-end pressures and the post-holiday return of currency to the banks. The Federal Reserve Banks cut down their holdings of government securities by $660 million in the first three weeks of January. Nevertheless, member bank discounts on January 21 were down to $862 million, lowest since October, as banks used incoming currency to pay down their borrowings. The discount rate advance commended this course to them.

### *Broader Significance*

There is no reason to believe that either the outgoing or incoming administrations raised any objection to the discount rate action. The Republican platform went on record as advocating "a Federal Reserve System exercising its functions in the money and credit system without pressure for political purposes from the Treasury or the White House." President Eisenhower, in his speech of October 22 devoted to inflation, referred to past conflicts between the Federal Reserve and Treasury over credit and money policies, stating:

> We shall not allow our government agencies to fight at the expense of the American people. We shall create

**an atmosphere in which the Federal Reserve Board and the Treasury Department can act, not as political enemies, but as economic allies in the war against inflation.**

From the immediate standpoint of the Treasury's refinancing problems, it is good to have the question of discount rate change out of the way. A discount rate out of harmony with the realities of the money market, stirring apprehensions of imminent change, does not provide a healthy basis for Treasury debt operations any more than it does for the prudent conduct of banking business.

From the longer run standpoint, the rate change serves as warning to banks not to abuse the discount rate privilege. The possibility of further change at some later point, should economic circumstances so dictate, is something the prudent banker must never forget, and gives a practical reason for restraint in lending when excesses of credit demand produce tight money markets and swollen borrowings from the Federal Reserve.

The rate action fits the broad principle laid out by witnesses — official and unofficial — at the hearings conducted by the Patman subcommittee last March, which in turn echoed the sense of the Douglas report of two years earlier. Chairman William McC. Martin of the Federal Reserve Board took the explicit position during the Patman subcommittee hearings:

> Member bank borrowing at the Federal Reserve should be the principal means of obtaining additional bank reserves. Discount rate changes and open market operations should be the main instruments through which credit and monetary policies are adapted to changing conditions in the economy. This means increased use of the discount mechanism, increased importance of discount rates in comparison with credit policy experience of the past decade, and reliance on open market operations to reinforce discount policy.

## Treasury Certificate Refunding

The Secretary of the Treasury, Mr. George M. Humphrey, announced after the close of business January 29 the plans for handling the $8,868 million 1⅞ per cent certificates of indebtedness maturing February 15. Holders of these securities are being offered in exchange a choice of:

2¼% one-year certificates of indebtedness due February 15, 1954;

2½% five-year ten-months bonds due December 15, 1958.

Exchange subscription books will open February 2. The early indications were that the offering will have a favorable response.

This is the largest single maturity on the Treasury calendar for the first half of 1953. The full 1953 calendar of maturities of marketable securities is as follows:

| | |
|---|---|
| 13 issues of 91 day series Treasury bills replaced weekly as they mature | $17.2 billion |
| 1⅞% certificates of indebtedness due February 15 | 8.9 " |
| Tax Anticipation series Treasury bills payable March 15-18 out of surplus tax revenues | 2.5 " |
| 1⅞% certificates of indebtedness due June 1 | 5.0 " |
| Tax Anticipation series Treasury bills payable June 15-19 out of surplus tax revenues | 2.0 " |
| 2% certificates of indebtedness due August 15 | 2.9 " |
| 2% bonds due September 15 | 8.0 " |
| 2⅛% notes due December 1 | 10.5 " |
| | $57.0 billion |

Of this aggregate, the $4½ billion Treasury bills redeemable out of March and June revenues will not have to be refunded. On the other hand, more than this amount prospectively will have to be borrowed to cover the seasonal deficit in the July-December period.

### *Dealing With Debt Structure*

Details on the Treasury's handling of the February 15 maturity had been awaited with great interest as an indication of shifts of policy the new Administration may introduce. The general impression has been that the Treasury will set out to improve the structure of the debt and relieve the burden of early maturities. Since we are bound to have a large public debt for an indefinite future, the best solution is to put out bonds maturing beyond 1972 when the last of the existing marketable debt will have come due. The expectation is that an issue of this sort will be offered for cash subscription later this year, market conditions permitting.

The optional exchange offering of certificates and short bonds represents a limited, probing move toward debt reconstruction. The Treasury expects the principal demand to be for the certificates. But, to whatever extent the bonds are taken, the prospective volume of refundings for 1954-57 will be chipped down. Applied to other maturities, with a longer bond, the technique over time could develop a considerable shift in debt distribution.

One merit in the option feature is that, in allowing the holder a choice, it increases the likelihood that he will make an exchange rather than demand cash at maturity or sell his exchange subscription rights in the market. At the same time, the market demand for the rights is increased by the availability of a two-way choice. This should relieve the risk of a failure and an uncomfortable cash drain on the Treasury.

The optional plan offers the holder of certificates a one-year extension at 2¼ per cent – better than he could get in the open market within a year's maturity limit – and extends the incentive of a ¼ per cent higher rate for taking a longer obligation. The differential is an expense to the Treasury of reducing refinancing burdens for a period of years. The holder of the 2½ per cent bonds will have no claim on the Treasury for his principal funds until 1958. Meanwhile, if he wants to break loose from his investment, he will have to take his chances on what the free market will pay. For a bond under six years to maturity this is not a big risk. Yet it is one the prudent investor has to measure.

The Treasury has used optional plans in the past, the last time in 1944. The standard postwar practice has been to offer certificates or notes, of one-year maturity or thereabouts, in exchange for maturing certificates, notes and bonds. This naturally has resulted in a tendency for short-term debt to accumulate save in periods when surplus revenues permitted debt retirement. From time to time in the postwar years, however, the Treasury has stemmed the accumulation of short-term debt by offering four and five year notes to holders of maturing paper. Last March $927 million five-to-seven year 2⅜ per cent bonds were issued to holders of a bond issue falling due. In July $4¼ billion six-year bonds, again paying 2⅜ per cent, were put out for cash subscription. These are the only two marketable bond issues that have been issued since the Victory Loan drive in December, 1945 which raised $15 billion by the sale of such bonds. Then, the government market had Federal Reserve pegs to guarantee success. Apart from last year's 2⅜'s, it is more than eleven years since the Treasury has put out a marketable bond issue on a comparatively free market. The Treasury and the market alike have a good deal to relearn, by trial and error, in handling major Treasury bond issues.

Swelling the volume of maturities the Treasury must meet this year and next are the three largest issues of ten-year 2 per cents issued during the war. Other governments face similar debt problems. The Canadian Government, anticipating maturity next year of a large war loan, is "feeling out" the market with a $100 million twenty-five year bond issue offering a yield to the investor of 3.85 per cent. In the United States the general impression is that the Treasury can borrow at long term within the interest rate range of 3 to 3¼ per cent.

One consideration that has to be borne in mind is the need to control the amount of long-term offerings so that, while Treasury borrowing cuts into excessive flows of credit to mortgage and corporate borrowers, it does not constrict unduly availabilities of funds in those uses. This is an illustration of the way public debt management can contribute to economic stability and also to the preservation of the value of the money in which bond values are expressed.

## The Federal Budget

The federal budget for the fiscal year 1954 commencing July 1, which Mr. Truman submitted to Congress last month before leaving office, reveals the magnitude of the fiscal task bequeathed to the new Administration.

In presenting his budget, the outgoing President referred to the "unique circumstances" under which it had been prepared and submitted as required by law, in that the executive responsibility for budgetary policy would pass almost immediately to his successor. Mr. Truman's estimate of the cost of bringing the country's defense build-up to a peak, plus the carrying forward of other far-flung activities embarked upon in twenty years of Democratic Administration, was $78.6 billion.

This would be $4 billion over the revised estimate for the current fiscal year, $12 billion over what was actually spent in fiscal '52, and $38 billion over fiscal '50, before Korea. Next year's projected spending would be the largest in history except for the peak years of global fighting in World War II.

**United States Government Budget Receipts, Expenditures, and Public Debt, 1914-1954**

**(In Millions of Dollars)**

| Year Ended June 30 | Total Net Receipts | Total Net Expenditures | Net Surplus or Deficit | Public Debt June 30 |
|---|---|---|---|---|
| 1914 | $ 735 | $ 735 | $ 0 | $ 1,188 |
| 1917 | 1,124 | 1,978 | — 853 | 2,976 |
| 1918 | 3,665 | 12,697 | — 9,032 | 12,244 |
| 1919 | 5,152 | 18,515 | —13,363 | 25,482 |
| 1920 | 6,695 | 6,403 | + 291 | 24,299 |
| 1925 | 3,780 | 3,063 | + 717 | 20,516 |
| 1930 | 4,178 | 3,440 | + 738 | 16,185 |
| 1932 | 2,006 | 4,741 | — 2,735 | 19,487 |
| 1935 | 3,800 | 6,592 | — 2,791 | 28,701 |
| 1940 | 5,296 | 9,206 | — 3,910 | 42,968 |
| 1941 | 7,227 | 13,387 | — 6,159 | 48,961 |
| 1942 | 12,696 | 34,187 | —21,490 | 72,422 |
| 1943 | 22,201 | 79,622 | —57,420 | 136,696 |
| 1944 | 43,892 | 95,315 | —51,423 | 201,003 |
| 1945 | 44,762 | 98,703 | —53,941 | 258,682 |
| 1946 | 40,027 | 60,703 | —20,676 | 269,422 |
| 1947 | 40,043 | 39,289 | + 754 | 258,286 |
| 1948 | 42,211 | 33,791 | + 8,419 | 252,292 |
| 1949 | 38,246 | 40,057 | — 1,811 | 252,770 |
| 1950 | 37,045 | 40,156 | — 3,111 | 257,357 |
| 1951 | 48,143 | 44,633 | + 3,510 | 255,222 |
| 1952 | 62,128 | 66,145 | — 4,017 | 259,105 |
| 1953 Est. | 68,697 | 74,593 | — 5,896 | 263,900 |
| 1954 Est.* | 68,665 | 78,587 | — 9,922 | 273,800 |

* Assuming tax decreases as scheduled under existing law.

Revenue receipts for next year are estimated at $68.7 billion, duplicating the all-time high of this year, and far surpassing the previous record tax collections during World War II.

Notwithstanding these unprecedented tax receipts, the excess of expenditures is now estimated at $5.9 billion for fiscal '53 and $9.9 billion for '54. The accompanying long-term summary shows the deficits of recent years and the renewed increase in public debt.

### *Where the Money Goes*

The following table giving expenditures arranged by magnitude of major classifications in fiscal '54 shows both where the bulk of the money goes and where the major increases over this year are projected.

**U.S. Government Expenditures by Major Programs, Fiscal Years 1952-54**
**(In Millions of Dollars)**

| | 1952 Actual | 1953 Est. | 1954 Est. | Change 1953-54 |
|---|---|---|---|---|
| Military services | $39,727 | $44,380 | $46,296 | +1,916 |
| International security | 5,268 | 6,035 | 7,861 | +1,826 |
| Interest on public debt | 5,934 | 6,520 | 6,420 | — 100 |
| Veterans' services | 4,863 | 4,546 | 4,564 | + 18 |
| Natural resources | 2,948 | 3,370 | 4,097 | + 727 |
| Social welfare | 2,491 | 2,594 | 2,579 | — 15 |
| Transport., commun. | 1,923 | 2,056 | 2,016 | — 40 |
| Agricultural resources | 1,045 | 1,943 | 1,827 | — 116 |
| General government | 1,411 | 1,385 | 1,547 | + 162 |
| Housing, com. facilities | 735 | 757 | 509 | — 248 |
| Education & research | 171 | 272 | 288 | + 16 |
| Fin., commerce, indus. | 241 | 458 | 275 | — 183 |
| Labor | 248 | 252 | 268 | + 16 |
| Res. for contingencies | — | 25 | 40 | + 15 |
| Adjustment | —855 | — | — | — |
| Total budget expend. | $66,145 | $74,593 | $78,587 | +3,994 |

It will be seen that, as in the past, the five biggest items — military services, international security, interest on the public debt, veterans' services, and natural resources (including atomic energy) — dominate the budget, comprising approximately $69 billion out of the $79 billion total. Likewise, three of these five classifications account for more than the $4 billion net increase in the total.

### *Task Facing the New Administration*

All this portrays the formidable task facing the new Administration in carrying out its election pledges to cut government spending drastically, and so to make a start towards reducing taxes. According to the timetable announced during the campaign, the immediate goal was a budget trimmed to around the $70 billion level in fiscal '54. To achieve this objective means, on the basis of the Truman budget, cutting out $8½ billion of projected expenditures, representing in many cases programs which have been in operation for years, and doing so in a matter of months by an Administration which has just come into office and by a new party leadership in Congress. While some of the Republican leaders have continued to express confidence that this can be done, the new Director of the Budget, Joseph M. Dodge, has been more guarded in his comments and cautioned the press and the public not to expect any "sixty-day miracles".

The fiscal problem is made more acute by the fact that a number of the tax increases voted in 1950 and 1951 following Korea will automatically terminate over the next eighteen months. These include the expiration on June 30, 1953 of the corporation excess profits tax, on December 31, 1953 of the temporary increases in the personal income taxes, and on March 31, 1954 of the temporary increases in the regular corporation income tax and in excise taxes. While the effect of these tax terminations was allowed for in the Truman budget for 1954, the estimated reduction of revenues for that year was only around $2 billion, whereas the reduction in a subsequent full year was placed at about $8 billion.

On the other hand, it is well to bear in mind the tendency of recent budgets to over estimate expenditures. For example, just a year ago when President Truman first presented his budget for fiscal 1953 he estimated expenditures at $85.4 billion. This was lowered last August to $79 billion and again last month to $74.6 billion — a total reduction of almost $11 billion. Reflecting mainly these successive downward revisions in expenditures, the indicated deficit was cut from an original $14.4 billion to $5.9 billion.

There is also the possibility that tax yields may have been underestimated, both because of the marked upswing that has taken place in general business activity, and because the statutory lowering of tax rates may not result in as great a loss of tax revenues as estimated. The latter applies particularly to the projected loss in revenue from termination of the excess profits tax, the elimination of which would encourage better control of business expenditures and thereby raise the operating income subject to the regular corporation income taxes. These rates remain at 52 per cent until April 1, 1954, and at 47 per cent thereafter.

### *Where Cuts Might Come*

There is no warrant, however, for sitting back with the easy assumption that trimming $8½ billion from expenditures in 1954, and eliminating the projected $9.9 billion deficit, can be accomplished painlessly. Achieving the goal is possible but it will take thorough-going, intelligent work to find where cuts are justified, and courage to make them.

National defense and international aid, by virtue of their overwhelming share of the budget and mushroom growth, offer the greatest possibilities. Extravagance and waste in the military services are proverbial, and testimony from innumerable sources is constantly exposing new

examples of shortcomings. Red tape, traditionalism, interservice rivalries proceeding from lack of real unification, and just plain prodigality are still handicapping efficiency in many directions, despite earnest efforts by conscientious administrators and officers to tighten up. President Eisenhower is himself authority for the statement that defense expenditures are where the greatest savings can be made, and that they can be accomplished without reduction of defensive power. Reaching this dual objective will provide a severe test of the ability of the new Administration and of Congress to carry out wisely and effectively their pledges of economy.

International aid, for which the Truman budget projects expenditures of $7.9 billion in fiscal '54, appears second on the list in point of vulnerability. Total budgeted outlays in this category next year exceed this year's estimated cost by $1.9 billion, and exceed actual outlays in fiscal '52 by more than $2½ billion. This is in the face of marked abatement of the world dollar shortage problem over the past twelve months, as shown by a rise of about $1 billion in gold and dollar assets of foreign countries during the period.

Members of Congress are becoming increasingly critical of these continued heavy expenditures for foreign assistance which, instead of tapering off with the passage of time, have increased. That our foreign aid programs provide a fruitful area for expenditure reduction is clear from studies made abroad by individual Congressmen and particularly by Mr. Truman's own mission to Europe, headed by the then Secretary of Commerce Charles Sawyer.

The Sawyer mission, in its report last December, found that there is a general assumption among the Europeans themselves that economic aid from the United States "is coming to an end." It stated that, while substantial military aid may still be needed in Europe, "we should not continue to provide economic aid under the disguise of military aid."

Commenting on the Point IV program, the Sawyer mission suggested that "a new look should be taken at the present handling and trend" lest it become "another give-away agency" in place of its original purpose of furnishing technical assistance to backward areas.

The report had this to say about the administration of our foreign programs: "There was an almost unanimous opinion that we have too many people and too many agencies in Western Europe." And while many of our representatives abroad were of high quality, "it would appear that their efficiency and morale are impaired by the fact that there are too many people doing too many things," the result being "confusion and wasted effort." The report suggested the abolition of emergency agencies no longer needed and "prompt reduction of the number of people employed."

It might be added that this report of overstaffing by U.S. agencies abroad is in line with many similar reports by news correspondents, returning Congressmen, and other travelers, who often are much less restrained in their comments. Everywhere, not merely in Western Europe, it is the same story of "too many people", many of whom, with generous government pay and "allowances", luxurious living quarters, and little to do, are described as "never having had it so good." Not only is this type of extravagance costing the American taxpayer dearly, but it is hurting us in the eyes of people we are trying to help.

### *Other "Soft" Spots*

While the size of the two leading categories – military services and foreign programs – make them the top targets for economy if expenditures are to be brought within receipts, there are vast savings possibilities in other directions.

Among many "soft" spots, a budget analysis by the Council of State Chambers of Commerce cites the Bureau of Indian Affairs. This Bureau, which had 5,789 employees in 1935, has 12,886 on its payroll today, and will be able to employ an average of 14,000 employees during 1954 under the Truman budget – meaning, the Council observes, "one bureaucrat in the Indian Affairs agency to every 28 Indians in the United States."

Another category, often regarded as untouchable but calling for scrutiny, is veterans' services and benefits, listed for outlays of $4½ billion in fiscal '54. It is unfortunately true that veterans' benefits have been widely abused, with resultant unwarranted hiking of costs to the taxpayers, including veterans themselves. Within the past year the press has carried a rash of complaints of alleged hardships inflicted upon patients in veterans' hospitals because of personnel reductions made necessary by the very modest economies in Veterans Administration appropriations voted by Congress in fiscal '53. But no mention is made of the fact that two-thirds of the patients in veterans' hospitals represent non-service-connected disabilities, which are not supposed to rate free hospitalization except where facilities are available and the veteran cannot afford private treatment – the latter requirement being taken very lightly. Were the intent of the law observed, there not only would be ample care available for all deserving veterans, but it

could be provided with far less hospital plant and service than is now in use. As it is, the Veterans Administration continues to plan still more hospitals to take care of more non-service-connected disability cases at public expense.

Mr. Truman in his budget message warned of the tendency of veterans' expenditures to increase, due both to the growing number of veterans and to the tendency of Congress to vote extension and liberalization of benefits. Noting that new veterans are now being discharged at the rate of approximately one million a year, he pointed out that if our armed forces continue at their present size, most of the people in the United States will eventually be veterans or dependents of veterans. In other words, veterans are fast losing their status as a special class for whom benefits can be voted and paid for largely out of someone else's pocket.

Proposed expenditures of $1.8 billion for agricultural programs, including $729 million for price supports, $239 million for rural electrification and telephones, and $254 million for so-called soil conservation payments, likewise suggest a fertile field for budget pruners. Congress in recent years has been consistently more generous to farmers than leading farm organizations have expected or desired. This includes extension of the program of 90 per cent of parity price supports for leading crops in the face of opposition by the American Farm Bureau Federation and the National Grange, which favored the more moderate sliding scale support principle; it also includes refusal to reduce soil conservation payments which some farm representatives have characterized as a "handout."

Still another area of possible savings is in the Department of Interior's ambitious and costly programs of reclamation, flood control, and electric power development. No one denies the legitimate opportunities for government activities in this field. But the Interior Department's aggressive promotion of public power, including the building of transmission lines which duplicate those of private systems, and its blocking of efforts by the private taxpaying utility companies to develop power sites so that it could do the job with public money, have both added to taxpayer burdens and smacked of socialism.

The post-election proposal by Dr. Paul J. Raver, for thirteen years head of the Bonneville Power Administration, of a plan for taking the power business of the Northwest out of the hands of the Federal Government and vesting it in a regional authority, may be a sign of a new spirit already in the Department. Confessing that he felt "a little astounded at my own temerity as a federal official," Dr. Raver remarked, "I don't know of any other federal official so heretical as to offer a suggestion involving abolishment of an agency which he heads." At least, it establishes a good precedent.

### *Promise vs. Performance*

The Eisenhower Administration was elected to office on the promise that it would cut government spending, reverse the twenty-year trend towards centralization of affairs in Washington, and reduce the heavy burden of taxes. Most of those elected to Congress last November based their campaigns on the same general promise.

Now is the time for the new Administration and the new Congress to take the first important steps towards translating promise into performance. Congress, and more specifically the House, will open the attack. Already Congressional leaders are at work on the problem. Speaker of the House Joseph W. Martin, Jr., outlined the Republican plan of action and the objectives in a speech last month as follows:

> Our leaders in Congress have already gone to work on this spending problem. In the House of Representatives, the chairman of the Appropriations Committee, Representative John Taber of New York, is putting together a staff of the ablest accountants, engineers, and personnel experts in the country to help the committee find out just exactly where the budget can be cut.
>
> This was the technique used by the same committee in the Republican 80th Congress in 1947 and 1948, and this technique got results. In both years the budget was balanced and the Treasury showed a very handsome surplus. Our aim is to achieve sufficient economies so that taxes may be cut.

Congress should not and will not work independently, but in cooperation with the Budget Bureau and with government departments. With real leadership and sympathy in the White House for what the appropriations committees of Congress are trying to do, their joint efforts should prove more fruitful than in the past. Even in this short time there is becoming visible in Washington a wholly new attitude toward the budget problem, and a growing conviction that it is possible to provide for better defense and for other essential government services while still reducing total expenditures.

All this determination can come to realization only if the economy efforts in Washington are supported by the people at home. Popular as economy may be in the abstract, it is seldom so in the particular, by reason of the fact that every spending cut affects someone's interest adversely. But here, as the Council of State Chambers of Commerce well puts it, the question of the nation's best interests arises, and the people must share with Congress and the new

Administration the burden of determining whether the balancing of the federal budget, looking toward tax reduction, is more in the national interest at this time than any capitulation they might make to the spending interests.

## The Services of Capital

In the December issue of this Letter we gave figures showing the immense amounts of new capital poured into enlargement and improvement of American industry during the war and postwar periods. It was shown that since 1940 the net absorption of new funds by the manufacturing industries alone has reached a grand total of approximately $100 billion. Some of these funds went into the carrying of larger inventories and into cash or government securities to provide greater liquidity or to carry on increased business, but most went to improve or modernize plants and to build new ones for the purpose of vastly increasing the output of goods and services needed to defend and sustain the American people.

The story told in these figures of corporate expansion over the past decade illustrates anew the services of capital in multiplying productivity and supplying the basis for progress in meeting the wants of the public. Capital has made possible more material goods — for both war and peace — and more leisure to enjoy the wealth of consumer products and facilities being brought increasingly within reach of the common man. We have seen how the heavy capital investments by the industries made possible the great outpouring of munitions during World War II. We have seen how, despite the huge rearmament program, industry since Korea has been enabled to turn out abundant supplies of civilian goods, first minimizing and eventually overcoming shortages.

### *Productivity and Economic Progress*

The experience in this country during the past decade is only the latest chapter in a long story of capital investment not merely supplying more facilities for production, but continually improving them through applications of new methods and techniques. By introduction of new and better tools and processes, productivity has been increased, costs reduced, and the real earning power of workers raised.

In a study just published by Professor Frederick C. Mills of the National Bureau of Economic Research entitled "Productivity and Economic Progress"* it is shown that a major factor in this huge increase of output was the almost uninterrupted rise, year after year, in the average output per manhour. He summarizes as follows four basic trends in the economy of the United States by ten-year periods, using index numbers based on the decade 1891-1900 as 100:

**Real Gross National Product, Population, Labor Input, and Productivity, United States, by Decades, 1891-1950**

| Decade | Gross national product (billions of 1929 dollars) | Gross national product (relative) | Population (relative) | Total manhours of labor input (relative) | Output per manhour (relative) |
|---|---|---|---|---|---|
| 1891-1900 | $294 | 100.0 | 100.0 | 100.0 | 100.0 |
| 1901-1910 | 455 | 154.8 | 120.6 | 126.1 | 122.8 |
| 1911-1920 | 603 | 205.1 | 143.4 | 140.5 | 146.0 |
| 1921-1930 | 838 | 285.0 | 165.4 | 145.1 | 196.4 |
| 1931-1940 | 843 | 286.7 | 181.9 | 122.8 | 233.5 |
| 1941-1950 | 1,493 | 507.8 | 201.4 | 180.5 | 281.3 |

It will be seen that gross national product, expressed in dollars of 1929 purchasing power so as to adjust for changes in the price level and to measure the aggregate physical output of the economy, increased from $294 billion in the decade 1891-1900 to $1,493 billion in 1941-50, or five-fold. Population doubled during the period, while the total manhours of labor input increased only 80 per cent, the difference reflecting the shortening of average working hours and the curtailing of work by children and old people. Total production kept increasing despite the shortening of working time because of the remarkable increase in productivity which, as measured by the average output per manhour, rose 181 per cent.

During this half century, the greatest economic expansion in gross national product occurred in the first, third, and fifth decades. The second decade, including World War I, brought a slower rate, while the fourth, including the severe depression of the 1930s, brought a major check. In the past decade the employed labor force grew to the largest in our history and this, combined with a further rise in productivity, gave us the tremendous increment to product upon which the country drew for both guns and butter.

### *Better Living Standards*

Professor Mills in his study makes careful measurement of the ways in which the great increment in product was used, pointing out that this distribution reflects the collective desires and needs of the people and indicates their pattern of economic life. Noting that consumption levels are persistent and change slowly, while capital equipment must be maintained if there is not to be retrogression, Mills computed the margin of product above that required for maintenance in each decade as compared with the preceding one. In the following table, this margin is shown, with the uses to which the increments were put during each period.

* National Bureau of Economic Research, Inc., 1819 Broadway, New York 23, N. Y. Occasional Paper No. 38. Price 75 cents.

**Uses of Margin Above Maintenance of Real Gross National Product in the United States, by Decades**

| Decade | Margin above maintenance | War and defense | Progress: Consumption increase | Progress: Net capital increase | Progress: Total for progress |
|---|---|---|---|---|---|
| | (billions of 1929 dollars) | | | | |
| 1901-10 | $144 | $ 4 | $85 | $55 | $140 |
| 1911-20 | 118 | 28 | 37 | 53 | 90 |
| 1921-30 | 223 | 8 | 140 | 75 | 215 |
| 1931-40 | 14 | 11 | —9 | 12 | 3 |
| 1941-50 | 558 | 228 | 285 | 45 | 330 |

Professor Mills points out that, apart from the protracted check that came in the 1930s, the advance was virtually unbroken and that by far the greatest factor in this gain was rising productivity. He declares that machines, plants, administrative methods, and men have improved in productive quality; equipment has grown in quantity; flexible power has been carried to assembly line and bench.

In overall terms for the whole period the increase in per capita spending during the 1941-1950 decade over the 1891-1900 period was 143 per cent. The "total for progress" rose substantially in each decade of the century, excepting the fourth, but at varying rates. In each of the decades, also excepting the fourth, the use of the increment to gross product was primarily to raise levels of consumption. In the words of Professor Mills:

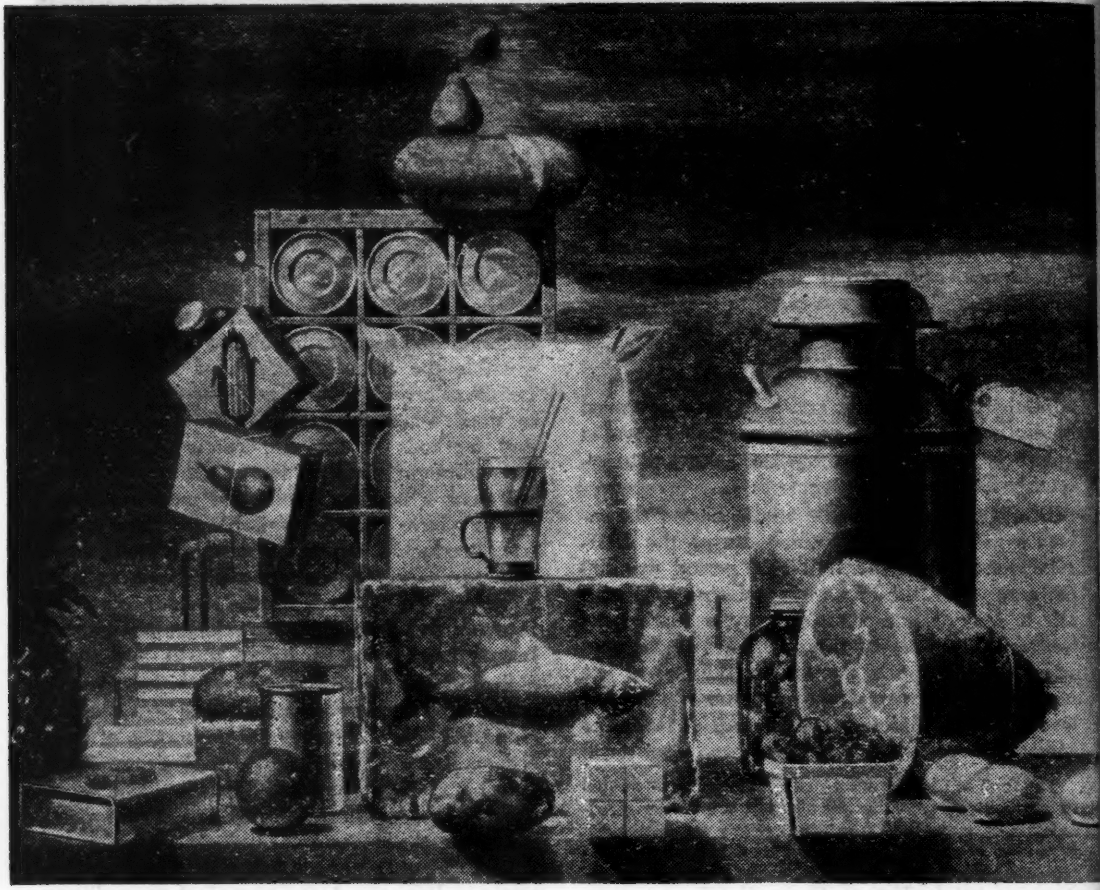
> The form of progress most richly and consistently aided by productivity gains has been progress in living standards. Such gains have also given steady support to the expansion of capital plant. They have helped to maintain established consumption standards when other instruments failed. The steadily re-created productivity increment has been, at once, the spearhead of progress and a reserve against emergency.

Of especially great interest is the record of the last decade, 1941-1950, during which, in spite of the tremendous costs of war, the combination of greatly increased labor input and rising productivity allowed remarkable increases in consumption levels, although the net capital increase for the decade was substantially less than during the first three decades of the century. For this decade the margin above maintenance totalled $558 billion, one-third of which was due to increased productivity, the remainder to an increase in labor input over the depressed 1931-1940 decade. Of this margin in the decade 1941-50, only 41 per cent went to defense despite huge wartime and postwar defense expenditures; 51 per cent went to increase consumption and 8 per cent to increase net capital — an amazing record.

This great expansion over the years in output of goods and services has raised in the only way possible the living standards of the American people to levels that are far above those achieved in most other countries. Improved machinery and methods in the manufacturing industries have brought such an increase in productivity and such a flood of goods that more and more workers have become available for those industries producing services instead. Higher wages and purchasing power generally have, in turn, increased the demands for the diverse services — theatres, professional sports, educational courses, beauty treatments, vacations, travel, and so on.

Striking as the rise in real wages has been, it gains even greater significance when it is set alongside figures showing the proportion of wage earners' incomes spent for various items. Food, housing, clothing, fuel and light, the basic necessities of life, for the 1890-1899 period comprised, according to the National Industrial Conference Board, all but 21 per cent of these expenditures — while in 1952 about 40 per cent of expenditures went for items outside of these categories, and the quality and quantity of the basic essentials had improved substantially.

Such notable economic progress refutes the old charge that capitalism means an increasing exploitation and poverty of the workers. As Professor Mills comments, "The thesis that industrial development is necessarily marked by increasing misery would be hard to defend in the light of this record."



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